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BEFORE THE ARIZONA CORPORATION COMMISSION

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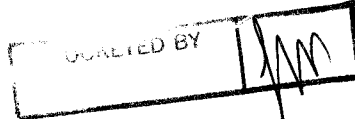
Arizona Corporation Commission

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JUN 30 1999

AZ CORP COMMISSION
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CARL J. KUNASEK
Chairman
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Commissioner
WILLIAM A. MUNDELL
Commissioner



IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-01933A-98-0471
TUCSON ELECTRIC POWER COMPANY FOR)
APPROVAL OF ITS STRANDED COST)
RECOVERY AND FOR RELATED APPROVALS,)
AUTHORIZATIONS AND WAIVERS.)

IN THE MATTER OF THE FILING OF TUCSON) DOCKET NO. ~~E-01933A-97-0772~~
ELECTRIC POWER COMPANY OF)
UNBUNDLED TARIFFS PURSUANT TO A.A.C.)
R14-2-1602 *et seq.*)

IN THE MATTER OF THE COMPETITION IN) DOCKET NO. RE-00000C-94-0165
THE PROVISION OF ELECTRIC SERVICES)
THROUGHOUT THE STATE OF ARIZONA.) NOTICE OF FILING

Pursuant to the Commission's Procedural Order dated June 23, 1999, Tucson Electric Power Company hereby files the Direct Testimony of James S. Pignatelli in the above-captioned matters.

RESPECTFULLY SUBMITTED this 30th day of June, 1999.

TUCSON ELECTRIC POWER COMPANY

By:

Bradley S. Carroll
Counsel, Regulatory Affairs
Legal Department - DB203
220 West Sixth Street - P.O. Box 711
Tucson, Arizona 85702

Original and ten copies of the foregoing
filed this 30th day of June, 1999, with:

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

1 **Copy of the foregoing hand-delivered**
2 **this 30th day of June, 1999, to:**

3 Carl J. Kunasek, Chairman
4 Jim Irvin, Commissioner
5 William A. Mundell, Commissioner
6 ARIZONA CORPORATION COMMISSION
7 1200 West Washington Street
8 Phoenix, Arizona 85007

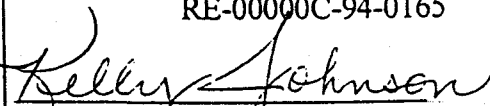
9 Jerry L. Rudibaugh, Chief Hearing Officer
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24 **Copy of the foregoing mailed**
25 **this 30th day of June, 1999, to:**

26 Distribution list for:
27 Docket Nos. E- 01933A-98-0471
28 E-01933A-97-0772
29 RE-00000C-94-0165

30 
By: Kelly Johnson
Secretary for Bradley S. Carroll

BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK

Chairman

JIM IRVIN

Commissioner

WILLIAM A. MUNDELL

Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-01933A-98-0471
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RECOVERY.)

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R14-2-1602 et seq.)

IN THE MATTER OF THE COMPETITION IN) DOCKET NO. RE-00000C-94-0165
THE PROVISION OF ELECTRIC SERVICES)
THROUGHOUT THE STATE OF ARIZONA.) **DIRECT TESTIMONY OF**
) **JAMES S. PIGNATELLI**
)

On Behalf of
TUCSON ELECTRIC POWER COMPANY

JUNE 30, 1999

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. James S. Pignatelli, 220 West Sixth Street, Tucson, Arizona 85702.

3 Q. WHAT IS YOUR POSITION WITH TUCSON ELECTRIC POWER COMPANY
4 ("COMPANY" OR "TEP")?

5 A. I am Chairman of the Board, President and Chief Executive Officer. I also hold these same
6 positions with TEP's parent company, UniSource Energy Corporation.

7 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

8 A. The primary purpose of my testimony is to provide a general overview and policy perspective
9 with respect to the Settlement Agreement dated June 9, 1999 ("Agreement") that was entered
10 into between TEP, the Residential Utility Consumer Office ("RUCO") Arizonans for Electric
11 Choice and Competition ("AECC")¹ and Arizona Community Action Association ("ACAA")
12 (collectively the "Parties").

13 Q. IN GENERAL, WHY DO YOU SUPPORT THIS SETTLEMENT PROCESS?

14 A. TEP has been an avid supporter of competition in the retail electric industry even before the
15 adoption of the Commission's Retail Electric Competition Rules ("Competition Rules") on
16 December 26, 1996. In anticipation of competition, TEP formed its holding company,
17 expanded into other competitive energy businesses and reduced its costs. These cost
18 reductions resulted in present and future rate decreases for TEP's customers. The Company
19 has been devoting significant resources to meeting the Commission's goal of bringing retail
20 electric competition to Arizona as soon as possible and has been working with many of the
21 interested parties to this end. However, in order for competition to become reality in Arizona
22 before the end of this year, certain crucial issues (which are addressed in the Agreement)
23 must still be resolved. I believe that this Agreement, and the process under which it is being
24
25
26

27 ¹ AECC consists of the following organizations: Arizonans for Electric Choice and Competition is a coalition of energy
28 consumers in support of competition and includes Cable Systems International, BHP Copper, Motorola, Chemical Lime,
29 Intel, Honeywell, Allied Signal, Cyprus Climax Metals, Asarco, Phelps Dodge, Homebuilders of Central Arizona,
30 Arizona Mining Industry Gets Our Support, Arizona Food Marketing Alliance, Arizona Association of Industries,
Arizona Multihousing Association, Arizona Rock Products Association, Arizona Restaurant Association, Arizona
Retailers Association, Boeing, Arizona School Board Association, National Federation of Independent Business,
Arizona Hospital Association, Lockheed Martin, Abbot Labs, and Raytheon.

considered, is the proper way to resolve those issues in a timely fashion in order to get competitive access underway for Arizona consumers.

Q. WHAT LED UP TO THE FILING OF THE AGREEMENT?

A. Pursuant to Commission Decision No. 60977 dated June 22, 1998 ("the Stranded Cost Decision") and A.A.C. R14-2-1607, Affected Utilities (such as TEP) were required to make a stranded cost filing with the Commission by August 21, 1998. Additionally, Affected Utilities were required to choose between two options for stranded cost. The first option, "the Divestiture Option," permitted an Affected Utility an opportunity to recover 100 percent of stranded costs if the Affected Utility divested itself of its generation assets. The second option, the "Transition Revenue Option," provided an Affected Utility less than 100 percent recovery, as it would only receive transition revenues for a period of time to permit the maintenance of financial viability.

As TEP has demonstrated throughout the electric competition proceedings, the opportunity for 100 percent stranded cost recovery is essential to the Company's financial viability. Moreover, under a transition from rate of return regulation to competition, TEP has maintained that it is entitled to a reasonable opportunity to recover its stranded costs. The "auction and divestiture" option was the only option that provided this opportunity. Consequently, on August 21, 1998, TEP filed its plan for stranded cost recovery which requested Commission authorization for the Company to auction off its generation assets to determine TEP's stranded costs. Pursuant to the Competition Rules, TEP had previously filed its unbundled distribution tariffs on December 31, 1997.

On April 14, 1999, the Commission approved Decision No. 61677, in which it modified the Stranded Cost Decision. Under Decision No. 61677, each Affected Utility could choose one of the following options: (a) Net Revenues Lost Methodology; and (b) Divestiture/Auction Methodology; (c) Financial Integrity Methodology; (d) Settlement Methodology; and (e) the Alternative Methodology. Decision No. 61677 was docketed by the Commission on April 27, 1999. On April 21, 1999, the Commission's Hearing Division issued a Procedural Order in which it set schedules for stranded cost proceedings for each Affected Utility. Pursuant to the Procedural Order, each Affected Utility was given an opportunity to amend its previously filed stranded cost recovery plan and unbundled tariffs

1 by June 14, 1999. Pursuant to the amended Stranded Cost Decision, the Parties entered into
2 negotiations to resolve outstanding issues which remained between them regarding stranded
3 costs, unbundled tariffs, the Competition Rules, and the outstanding litigation. Having
4 reached resolution, which the Parties agree is in their respective best interests and is fair and
5 equitable, the Agreement was executed and filed with the Commission pursuant to
6 Option (d).

7 Q. PLEASE OUTLINE THE MAJOR PROVISIONS OF THE AGREEMENT.

8 The major provisions of the Agreement are as follows:

- 9 • Rate reductions for all customers.
- 10 • Rate certainty for all standard offer customers through 2008.
- 11 • The establishment of an agreed upon stranded cost recovery methodology and
12 recovery plan for TEP which provides the Company a reasonable opportunity to
13 recover its stranded costs while providing competitive choices for generation and
14 other retail services to TEP's customers.
- 15 • The establishment of TEP's unbundled distribution tariffs for both standard offer
16 customers and customers that choose Competitive Retail Access.
- 17 • TEP's assurance that it will continue programs for low income customers.
- 18 • Waivers of certain Commission Rules and Orders which will permit the Company to
19 properly transition from a regulated to a competitive marketplace.
- 20 • Provision for a Code of Conduct to govern transactions between TEP and its
21 competitive affiliates.
- 22 • Resolution of pending and proposed litigation which otherwise could have
23 indefinitely delayed the introduction of Competitive Retail Access in Arizona
24 indefinitely.

25 Q. WHAT ARE SOME OF THE OVERALL BENEFITS OF THIS AGREEMENT?

26 A. I believe that there are significant benefits including the following:

- 27 • The Agreement addresses two crucial issues that needed to be resolved before
28 competition could commence in TEP's service territory, the recovery of stranded
29 costs and the Commission approval of TEP's unbundled distribution tariffs.

30 ...

- The Agreement provides for rate stability for TEP's distribution customers by establishing unbundled distribution rates that will remain in effect during the transition period through 2008. Additionally, all TEP's customers will receive the benefit of an additional two percent rate decrease during the transition period.
- TEP will continue funding systems benefits charges, including its low income, DSM and renewable programs, at current levels.
- Commitment to the AISA which provides for quicker non-discriminatory open access and movement towards the establishment of the ISO.
- The Agreement addresses vertical market power concerns raised by some of the parties. Under the Agreement, TEP will transfer its generation and other competitive assets to a separate subsidiary. At this point, TEP will not continue to operate as a vertically integrated utility. The potential for assertion of vertical market power will be eliminated.
- The Agreement allows the Commission to retain complete oversight over the implementation of the Agreement, as well as over TEP on a going-forward basis.
- The Agreement provides TEP an opportunity to continue rebuilding its financial integrity, thereby resulting in a financially healthy and stable Utility Distribution Company ("UDC") to serve the distribution needs of the customers of Southern Arizona.
- Finally, the Agreement ensures that TEP will not pursue its litigation options with respect to the Commission's ability to implement the Competition Rules, thereby removing a major potential impediment to the introduction of competition.

Q. PLEASE EXPLAIN IN DETAIL THE PROVISIONS OF THE AGREEMENT. FIRST, WHEN AND HOW WILL TEP'S CUSTOMERS BE ABLE TO ACCESS THE COMPETITIVE MARKET UNDER THIS AGREEMENT?

A. Under the Agreement, TEP will open up its service territory to (Commission-certificated) competitive retail access sixty (60) days after the issuance of a Commission order approving the Agreement, consistent with the proposed amended Competition Rules. At such time, twenty percent of TEP's 1995 system peak load or approximately 323 megawatts will be made available to for competitive retail access, including: (i) customers whose usage is one

megawatt or greater; (ii) 40 kW and greater customers that aggregate to loads of at least one megawatt; and (iii) a percentage of TEP's residential customers as specified in the proposed amended Competition Rules (currently five percent or approximately 14,800 customers) that will increase on a quarterly basis until January 1, 2001. Additionally, an additional 54 megawatts will be made available to eligible commercial and industrial customers. On January 1, 2001, all TEP's customers will be eligible to choose Competitive Retail Access.

Q. PLEASE DESCRIBE TEP'S STRANDED COST RECOVERY PLAN.

A. TEP's stranded cost recovery plan is based on three key principles. First, the plan provides rate stability to its distribution customers during the transition to a competitive retail market. The standard offer rate freeze specified in the Agreement will follow the rate decreases which will be implemented in 1999 and 2000, and will ensure that customers are benefited by the introduction of retail competition. Second, the stranded cost recovery plan facilitates the development of a competitive retail market for generation services. Through the use of a Market Generation Credit ("MGC") that reflects prevailing market prices for energy, competitive energy suppliers will have a reasonable opportunity to meet or compete with the energy components included on TEP's standard offer billings. Third, TEP will have a reasonable opportunity to recovery 100 percent of its stranded costs over the stranded cost recovery period. By applying two separate charges for stranded cost recovery, a Fixed Competition Transition Charge ("Fixed CTC") and a Floating Competition Transition Charge ("Floating CTC"), TEP will have a reasonable opportunity to recover its above-market generation costs under a variety of competitive market pricing scenarios.

Q. PLEASE EXPLAIN HOW THE FIXED AND FLOATING CTC WILL BE CALCULATED.

A. The Fixed CTC will be calculated for each customer class, resulting in an average charge of 0.93 cents/kWh. This average charge is what a customer class would realize if it had an annual load factor equal to the TEP system average annual load factor. The Fixed CTC will terminate when it has yielded a stranded cost recovery of \$450 million, or on December 31, 2008, whichever occurs first. When the Fixed CTC terminates, unbundled service charges will be reduced by the same amount. The Fixed CTC will be different for each customer class, depending on the annual load factor for that customer class. The Fixed CTC for each

...

customer class is detailed in the Company's proposed Fixed CTC by Class - Rider No. 4, which was included in TEP's unbundled distribution tariffs and attached hereto.

The Floating CTC will be calculated using a MGC and will terminate on December 31, 2008. The Floating CTC amount will equal the difference between the customer's bundled rate and the sum of: (i) the MGC; (ii) the "Adder"; and (iii) the unbundled service charges for: a) distribution; b) transmission; c) meter services; d) meter reading services; e) billing and collection; f) demand-side management system benefits charge; g) customer information and life-line discount system benefits charge; h) uncollectible accounts; i) ancillary services (*see* TEP's proposed Transmission and Ancillary Services – Rider No. 3 attached hereto); j) fixed must-run generation (*see* TEP's Must-Run Generation – Rider No. 2 attached hereto); and k) fixed CTC (*see* TEP's proposed Fixed CTC by Class – Rider No. 4 attached hereto). In a given quarter, the Floating CTC can have a negative value, in which case the negative value will be credited to the customers' monthly bill.

In light of the potential benefits in reducing financing costs to TEP and its customers, TEP is requesting that the Commission authorize TEP to securitize a portion of either the Fixed or Floating CTC. Before any securitization could occur, TEP would file with the Commission a financing application that specifies the securitization structure and the benefits that would be shared with TEP's customers.

Q. WHY DOES THE AGREEMENT SPECIFY BOTH A FIXED AND A FLOATING COMPONENT OF STRANDED COST RECOVERY?

A. There are two primary reasons. First, although it is possible to estimate stranded costs based on expected future market prices, actual competitive market energy prices may turn out to be higher or lower than predicted. Through the use of a Floating CTC that moves inversely with the market price of energy, TEP's total stranded cost recovery will ultimately reflect the actual market price of energy experienced during the stranded cost recovery period. Second, it is necessary to have a floating component of stranded cost recovery in order to meet the dual objectives of (i) standard offer rate stability; and (ii) development of a competitive generation services market. If stranded cost recovery could be achieved only through a fixed CTC, and standard offer customers are guaranteed a rate freeze, the MGC would, by definition, be a fixed charge as well. Since the MGC represents the avoidable energy charge

1 on a standard offer billing, it is likely that very few distribution customers would choose a
2 competing energy supplier if the MGC were fixed at a level significantly below the market
3 price of energy. Conversely, it is likely that very few distribution customers would remain
4 on standard offer service if the MGC were fixed at a level significantly higher than the
5 market price of energy. Since competitive energy prices may prove to be rather volatile, it is
6 preferable to base the MGC on prevailing market prices and implement a floating CTC to
7 preserve standard offer rate stability.

8 Q. IS THE FLOATING CTC ALSO IMPORTANT FROM AN ACCOUNTING
9 PERSPECTIVE?

10 A. Yes. In order to avoid accounting losses, it must be probable that TEP will recover all of its
11 stranded costs. The Floating CTC recovers stranded costs that are not recovered through the
12 Fixed CTC. The Floating CTC allows recovery of stranded costs that arise due to generation
13 market fluctuations. Without the Floating CTC, TEP would have write-offs unless the Fixed
14 CTC were significantly increased to provide sufficient "headroom" to ensure recovery of all
15 stranded costs.

16 Q. WILL COMPETITIVE ENERGY SERVICE PROVIDERS ("ESPs") HAVE A
17 REASONABLE OPPORTUNITY TO COMPETE UNDER THE TERMS OF THE
18 AGREEMENT?

19 A. Yes. As I discussed earlier, the MGC represents the avoidable cost of energy to a standard
20 offer customer. Since it will be based on prevailing market prices, as measured by the Palo
21 Verde index, and adjusted for load factor by customer class, ESPs will have a reasonable
22 opportunity to compete with the energy charges included on TEP's standard offer billings.

23 Q. PLEASE ELABORATE ON THE MGC PROPOSAL.

24 A. The monthly MGC amount will be calculated in advance and stated as both an on-peak value
25 and an off-peak value. The monthly on-peak MGC component will be equal to the market
26 price multiplied by one plus the appropriate line loss. The market price will be equal to the
27 Palo Verde NYMEX futures price, except when adjusted for the variable cost of TEP's must-
28 run generation. The off-peak MGC component shall be determined in the same manner as
29 the on-peak component, except that the Palo Verde futures price will be adjusted by the ratio
30 of off-peak to on-peak hourly prices from the California Power Exchange of the same month

from the preceding year. The market price will reflect the cost of serving a 100 percent load factor customer. That price will be increased by an Adder.

Q. WHAT IS THE PURPOSE OF THE ADDER?

A. The purpose of the Adder is to estimate the cost of supplying power to a specific customer or customer group and stratum relative to the value of the NYMEX futures prices used in the calculation of the market price for a 100 percent load factor. The Adder is adjusted by customer class and stratum based on load shapes, as detailed in TEP's proposed Adder Associated with MGC – *see* Rider No. 1 attached hereto. The adders are at least 2.5 mills per kWh, and will typically range from 3.7 to 4.7 mills per kWh for residential and small commercial customers. The Agreement contemplates that after June 1, 2004, Adders may be adjusted to reflect market conditions.

Q. WHAT IS THE EFFECT IMPLEMENTATION OF THE AGREEMENT IS EXPECTED TO HAVE ON TEP'S FINANCIAL CONDITION?

A. TEP will have a reasonable opportunity to recover its stranded costs. By doing so TEP can avoid write-downs of its assets, and resultant damage to its already fragile balance sheet. TEP will have a reasonable opportunity to sustain its current level of earnings and cash flow, which will enable TEP to gradually strengthen its balance sheet through earnings retention and debt retirement. The presence of a Floating CTC also serves to add stability to TEP's earnings and cash flow during the transition to a fully competitive market. However, in no event will the Floating CTC extend beyond December 31, 2008.

Q. PLEASE DESCRIBE THE GENERAL COMPONENTS WHICH MUST BE INCLUDED IN A STRANDED COST RECOVERY PLAN SO THAT NO ACCOUNTING LOSSES ARE INCURRED BY TEP.

A. In order to avoid losses, the stranded cost recovery plan must include:

- Specific recovery of 100 percent of stranded costs including all related income tax ramifications of the recovery mechanism. Specific and stated recovery of all regulatory assets.
- A true-up mechanism which ensures recovery of the specified stranded costs in the event that the recovery path initially established becomes inadequate for recovery of the full amount of stranded costs.

- Recovery of the stranded costs is over a relatively short period and less than ten years.

- Recovery must come from regulated revenues rather than competitive revenues.

Q. DOES THE STRANDED COST RECOVERY MECHANISM IN THE AGREEMENT SATISFY THESE REQUIREMENTS?

A. Yes, it does. The stranded cost recovery mechanism in the Agreement satisfies these requirements as follows:

- The Fixed CTC is designed to recover 100 percent of the \$450 million of stranded costs.
- The June 2004 review described in the Agreement, together with any "headroom" in the Floating CTC, provides the true-up mechanism.
- Recovery is over a relatively short period and less than the ten-year maximum.
- Recovery will come from the customers of the cost-based rate regulated distribution operations.

Q. HOW WILL THE APPROVAL OF THE AGREEMENT CHANGE TEP'S ACCOUNTING?

A. TEP generally uses the same accounting policies and practices used by unregulated companies for financial reporting under generally accepted accounting principles. However, sometimes these principles, such as Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* ("FAS 71"), require accounting treatment to show the effect of regulation. For example, in setting TEP's retail rates, the Commission may not allow TEP to charge its customers currently to recover certain expenses but instead, require that these expenses be recovered from customers in the future. In this situation, FAS 71 requires that TEP capitalize and report these expenses as regulatory assets on the balance sheet until TEP is allowed to charge its customers. TEP then amortizes these items to the income statement as those amounts are recovered from customers. Similarly, certain items of revenue may be deferred as regulatory liabilities, which are also eventually amortized to the income statement. TEP has recorded regulatory assets and liabilities in accordance with FAS 71. When the Commission approves the Agreement, TEP will be required to stop accounting for its generation operations using FAS 71.

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1 Q. PLEASE DESCRIBE THE VARIOUS UNBUNDLED SERVICE CHARGES DETAILED
2 IN YOUR PRIOR DESCRIPTION OF THE CTC CALCULATION.

3 A. All of these charges are detailed for each customer class in TEP's proposed unbundled
4 distribution tariffs. Unbundled charges fall into categories as outlined below:

- 5 • Required for Direct Access Service
 - 6 (i) Distribution
 - 7 (ii) Fixed Must-Run Generation
 - 8 (iii) Fixed CTC
 - 9 (iv) Floating CTC
 - 10 (v) Demand Side Management System Benefit Charge
 - 11 (vi) Customer Information and Lifeline Discount System Benefit Charge
 - 12 (vii) Uncollectible Account Charge
- 13 • Required for Direct Access, but may be Purchased from a Qualified Third Party
 - 14 (i) Meter Services
 - 15 (ii) Meter Reading Services
 - 16 (iii) Billing and Collection

17 As described in TEP's proposed Direct Access Tariffs, transmission is required for
18 direct access service, but is not purchased directly by the customer. Instead, transmission and
19 ancillary services are sold to scheduling coordinators pursuant to TEP's Federal Energy
20 Regulatory Commission ("FERC") Open Access Transmission Tariff ("OATT").

21 Q. HOW ARE THESE UNBUNDLED CHARGES CALCULATED?

22 A. First, please focus on the subset of the unbundled items listed above that constitute the
23 distribution cost of service study. Specifically, these items are distribution, demand-side
24 management, system benefits, customer information and lifeline discount system benefits,
25 uncollectible accounts, meter services, meter reading services, and billing and collection.
26 When these distribution cost of service items are added to transmission, one obtains the total
27 transmission and distribution ("T&D") component. The system average cost to TEP to
28 provide T&D service is 2.6 cents per kWh. T&D costs were allocated to customer classes
29 using the methodologies approved in TEP's last general rate case. The functional unbundling
30 of total class costs was guided by the goal that the sum of unbundled components for direct

access service should sum to bundled rates for standard offer customers.

Second, the remaining unbundled items of fixed must-run generation and Fixed CTC are based on cost analysis and class load shapes. Fixed must-run, like Fixed CTCs vary by class based on class annual load factor. As mentioned above, the remaining item, the Floating CTC is the rate freeze amount less the other components.

Q. HOW DOES THIS STRANDED COST RECOVERY PLAN IMPACT THE RATES THAT TEP'S CUSTOMERS WILL PAY DURING THE TRANSITION PERIOD?

A. Following the rate reductions discussed herein, TEP's standard offer and unbundled rates will remain frozen until December 31, 2008. However, on or before June 1, 2004, TEP will file with the Commission's Director of Utilities a report identifying any modifications to the Fixed or Floating CTC, TEP's distribution tariffs and other unbundled components that would have the effect of *reducing* standard offer and/or overall unbundled rates. This report will include a recommendation as to whether the Fixed CTC can be eliminated or reduced prior to December 31, 2008. What this provision does is assure TEP's competitive and non-competitive customers rate stability for over nine years, wherein TEP's rates will either stay the same or be reduced. Let me make it clear that, absent an extraordinary or emergency situation as defined in the Agreement, TEP's rates can not increase but can only decrease.

Q. HOW WILL TEP SEPARATE ITS COMPETITIVE AND NON-COMPETITIVE ASSETS?

A. Pursuant to the Agreement and consistent with the intent of the Competition Rules, on or before December 31, 2002, TEP shall transfer its generation and other assets deemed competitive (as defined in the Competition Rules) to a subsidiary of TEP. By transferring such assets, TEP will remain a regulated UDC, while its competitive activities (including generation) will be conducted by separate subsidiaries. This transfer, along with the requirement under the Competition Rules that standard offer generation must be procured from the open market, will have mitigated vertical market power concerns in the areas of generation and other competitive services. Moreover, the proposed Code of Conduct will prohibit cross-subsidization and other activities that would permit TEP's competitive affiliates from leveraging off the regulated monopoly.

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1 Q. WHY WILL THE GENERATION ASSETS BE TRANSFERRED INTO A SUBSIDIARY
2 OF TEP AS OPPOSED TO A SUBSIDIARY OF UNISOURCE?

3 A. TEP's lease, loan and mortgage agreements limit asset transfers. The specific limitations
4 vary but almost all the agreements restrict transfers of this magnitude to an affiliate of TEP
5 unless creditor approval has been obtained. Asset transfers to a TEP subsidiary, however, are
6 generally permitted under certain circumstances. Because the various agreements
7 contemplate transfers to subsidiaries, we believe this type of transfer will be easier and less
8 costly to establish and, therefore, the preferred method to initially separate TEP generation
9 assets from its distribution assets. Appropriate firewalls will be established, in part with the
10 Code of Conduct, to separate the two businesses.

11 Q. PLEASE DESCRIBE THE RATE REDUCTIONS THAT TEP'S CUSTOMERS WILL
12 RECEIVE?

13 A. In contrast to TEP's previous rate reduction order, which required TEP's future rate
14 reductions to be given only to customers not eligible to access the competitive market, under
15 the Agreement *all* non-special contract customers will receive a one percent decrease on July
16 1, 1999 and a one percent decrease on July 1, 2000. For standard offer customers, this will
17 apply to their entire TEP bill. For customers choosing direct access, this will apply to TEP's
18 unbundled distribution charges. Additionally, as discussed above, TEP's customers may
19 receive further reductions after the June 1, 2004, filing.

20 Q. PLEASE DESCRIBE HOW THE AGREEMENT ADDRESSES TEP'S LOW INCOME
21 PROGRAMS.

22 A. TEP has always supported low income programs and continues to do so in this Agreement.
23 To ensure that low income customers and programs are not adversely impacted by the
24 introduction and transition to competitive retail access, TEP's system benefits charge includes
25 charges to maintain its existing low income programs (which include weatherization, Life
26 Fund, bill assistance and rate discounts) in an amount of at least current levels through
27 December 31, 2004, when all such programs will be reviewed as part of TEP's June 1, 2004,
28 filing. The components of the system benefits charge are set forth in the unbundled
29 distribution tariffs filed with the Agreement. Additionally, the Agreement recommends
30 changes to TEP's low income discount program. The intent of the changes is to increase

1 participation through a simplification of the program. Specifically, the amendments are as
2 follows:

- 3 • It would replace the current percentage discounts with a flat eight dollar (\$8.00)
4 per month discount;
- 5 • The applicant for the program must receive the bill in their name, be a residential
6 customer and meet one-hundred fifty percent of the federal poverty income
7 guidelines; and
- 8 • The program would operate as follows: (i) the program would have an application
9 which is self-declared/self-addressed and available in English and in Spanish; (ii)
10 once TEP receives the application, it would be reviewed; (iii) once the customer
11 has been determined to be eligible, the discount would become effective
12 immediately; (iv) participants who move within TEP's service territory would
13 have their eligibility transferred with them; and (v) the customers would be
14 notified annually by TEP when it is time to reapply.

15 Q. PLEASE DESCRIBE HOW TRANSACTIONS BETWEEN TEP AND ITS COMPETITIVE
16 AFFILIATES WILL BE GOVERNED.

17 A. As part of this Agreement, TEP will be filing an Interim Code of Conduct which will govern
18 transactions between TEP (the regulated UDC) and its affiliates engaged in competitive retail
19 access. TEP believes that the Interim Code of Conduct contains all necessary provisions to
20 ensure commencement of competitive retail access on a "level playing field" in TEP's service
21 territory. Upon final adoption of the Competition Rules, TEP shall file for Commission
22 approval a final Code of Conduct consistent with the Competition Rules.

23 Q. DOES THE AGREEMENT PROVIDE FOR THE MODIFICATION OF TEP'S CC&N TO
24 PERMIT COMPETITIVE RETAIL ACCESS IN ITS SERVICE TERRITORY?

25 A. Yes. Under the Agreement, TEP agrees to a modification of its CC&N to permit competitive
26 retail access in its service territory. The resolution of TEP's stranded cost is the final aspect
27 of TEP's Section 40-252 hearing necessary for the Commission to modify the Company's
28 exclusive CC&N.

29 ...

30 ...

1 Q. HOW DOES THE AGREEMENT ADDRESS THE NEED FOR INDEPENDENT
2 ADMINISTRATION OF TRANSMISSION UNDER COMPETITIVE RETAIL ACCESS?

3 A. Under the Agreement, TEP supports the development of the Arizona Independent Scheduling
4 Administrator ("AISA") and the ultimate formation of Desert STAR, the Independent System
5 Operator ("ISO"). This is consistent with the Competition Rules and the Federal Energy
6 Regulatory Commission's ("FERC") recent Notice of Proposed Rulemaking on Regional
7 Transmission Organizations. TEP will modify its FERC OATT to be fully compatible with
8 the AISA/ISO Bylaws and Protocols Manual and will, within ten (10) days of Commission
9 approval of the Agreement, modify its OATT with FERC to facilitate the commencement of
10 competitive retail access in TEP's service territory.

11 Q. UNDER THE AGREEMENT, HOW WILL TEP TREAT ITS OUTSTANDING
12 LITIGATION AGAINST THE COMMISSION?

13 A. Upon issuance of a final order approving the Agreement that is no longer subject to judicial
14 review, TEP will dismiss with prejudice all pending litigation brought by TEP against the
15 Commission relating to the Competition Rules and the Stranded Cost Decision. Further, TEP
16 has agreed to assist the Commission in any remaining litigation regarding implementation of
17 the Competition Rules.

18 Q. PLEASE DESCRIBE THE SPECIFIC WAIVERS THAT TEP HAS REQUESTED IN THE
19 AGREEMENT THAT THE COMMISSION APPROVE.

20 A. Holding Company Conditions - Decision No. 60480, Attachment A

21 *General* - The conditions set forth in Decision No. 60480 were designed to address TEP as a
22 vertically integrated utility on a going forward basis indefinitely and to provide safeguards to
23 protect the utility and its customers. Since the Commission entered this Decision, the
24 Commission has adopted the Competition Rules, which requires the disaggregation of the
25 vertically integrated utility. The Competition Rules also provide for an affiliate Code of
26 Conduct and compliance filings with the Commission. Therefore, TEP believes that the
27 conditions set forth below are either unnecessary, inconsistent with the Competition Rules or
28 will put the Company at a competitive disadvantage as it enters the competitive market place.

29 ...

30 ...

Many of the relevant safeguards set forth in these conditions were contained in the Affiliate Transaction Rules, which will be replaced with the requirement for the affected utility to file a Code of Conduct.

Condition No. 2 – Allocation - This condition requires that the Holding Company, TEP and sister companies charge the lower of fully allocated cost or market price whenever goods, products or services are sold/provided by the Holding Company or sister companies to TEP and the higher of fully allocated cost or market whenever TEP sells/provides non-tariffed goods, products or services to the Holding Company or sister companies. It also contains compliance items for annual transfers in excess of \$500,000. These concepts, as well as other affiliate relationships and transactions and compliance requirements, will be set forth in the Code of Conduct.

Condition No. 12 – Annual and Quarterly Reports - This condition provides for the annual and quarterly reports of the Holding Company, TEP and sister companies on both a consolidated and individual-company basis. Although TEP has no objection to filing such reports on a consolidated basis, TEP believes that it is inappropriate to require such reports on an individual-company basis. First, such information would be proprietary and confidential and would have to be filed with the Commission on such basis. Second, it puts an additional burden on the Company not placed on its competitors. And finally, in light of the Code of Conduct.

Condition No. 13 – Non-Clerical Personnel Report - This condition requires that the Commission be furnished annually with a report identifying any non-clerical TEP personnel moved to the Holding Company or its subsidiaries on a full time basis. This condition is now unnecessary in light of the Code of Conduct.

Condition No. 17 – Capitalization - This condition provides that the capitalization of the sister companies (debt and equity) may not exceed 30 percent of TEP's capitalization unless otherwise approved by the Commission. In light of the proposed Rules' requirements that competitive services be conducted through unregulated affiliates, TEP's capitalization will decline significantly with the transfer of generation assets to a subsidiary or affiliate. The Company's total capitalization on a stand-alone basis will likely be less than \$1 billion following the transfer. Consequently, retaining the 30 percent cap will severely limit the

unregulated business growth prospects and the ability to diversify the portfolio of projects/companies. It also would put TEP at a severe competitive disadvantage in that its competitors do not have a similar restriction.

Condition No. 19 – Public Equity Issuances - This condition provides that through 2003, the following proceeds will be used to reduce TEP's debt or added to TEP's equity accounts: a) 60 percent of any public equity issuances by UniSource; and b) two percent of the net after-tax profits attributable to the Holding Company's equity interest in sister companies (the two percent will be split as follows: 50 percent to reduce TEP's debt or added to TEP's equity accounts and 50 percent to directly lower rates.) As TEP will separate its generation, the capital structure of the UDC will be dramatically redefined. Also, since TEP will have stable earnings and a better opportunity to attain a reasonable capital structure with the successful implementation of its stranded cost recovery pursuant to the Agreement, there is no need to mandate a portion of UniSource equity issuances for TEP. For this same reason, the need to limit dividends (Condition No. 20) and to predetermine the capital structure of TEP (Condition No. 21) is unnecessary and inappropriate. TEP's level of equity capital, which is impacted by dividends and by equity contribution from UniSource, is monitored by the regulation of TEP. Finally, reductions in TEP's standard offer rates have already been addressed in the Agreement. Therefore, there is no further need to mandate that one percent of the net after-tax profits attributable to the Holding Company's equity interest in sister companies be used to reduce TEP's rates.

Condition No. 20 – Dividends - This condition provides that until such time as TEP's equity ratio equals 37.5 percent of total capital, TEP will not issue dividends to UniSource which comprise more than 75 percent of TEP's earnings. TEP believes this condition is now unnecessary and inappropriate for the reasons set forth in Condition No. 19 above.

Condition No. 21 – Capital Structure - This condition provides that TEP will target a 37.5 percent equity ratio in its capital structure by December 31, 2000. If the capital structure is not attained and the equity ratio is less than 37.5 percent by that date, the Commission may set rates for TEP based upon its actual capital structure at that date rather than the hypothetical 37.5 equity/62.5 percent debt capitalization currently included in rates. TEP believes this condition is now unnecessary and inappropriate for the reasons set forth in

Condition No. 19 above. Further, it is also inconsistent with the concept of the rate freeze, which is an integral component of the Agreement.

Condition No. 23 – Job Descriptions - This condition provides that UniSource, TEP and sister companies will maintain up-to-date job position descriptions which clearly delineate duties and responsibilities, will state whether the position can be expected to work for more than one entity, and if the position is at the UniSource level, whether the duties relate to corporate governance functions and whether the duties and responsibilities of the position benefit more than one subsidiary. In light of the adoption of a Code of Conduct, this condition is unnecessary and puts TEP at a competitive disadvantage by requiring something of the Company that is not required of its competitors.

Condition No. 25 – Time Sheets - This condition provides that all employees below the Vice President level, who work for more than one department or responsibility area who may be called upon to work for more than one entity, keep detailed time sheets on a “positive” basis. Officers at the Vice President level and above must keep time sheets on an “exception” basis. It also provides that for future rate cases, if Staff finds the allocations unreasonable, there will be a rebuttable presumption that the resources of the employees should be allocated between regulated and unregulated activities in the same percentage as their respective percentage of capital investments.

With respect to the time sheets, in light of the adoption of the Code of Conduct, this condition is unnecessary and puts TEP at a competitive disadvantage by requiring something of the Company that is not required of its competitors. On the issue of the allocations, for the reasons stated in Condition No. 19 above, this treatment is unnecessary and inappropriate.

Condition No. 26 – M&A Activity - This condition provides that all TEP and UniSource employee time spent on mergers, acquisitions and new business development will be tracked for below-the-line recording and/or assignment to the new business. TEP believes that it is inappropriate to apply this to TEP given the Rules' mandate to transfer competitive functions to affiliates. As this activity has now been *mandated* by the Commission, it is inappropriate for TEP to be required to track this below-the-line. Further, this issue would be more properly addressed in a post-transition rate filing for the UDC.

1 *Condition No. 27 – Annual Document Filing* - This condition requires TEP to file an
2 annual report identifying nine types of information relating to interrelationships between
3 TEP, the Holding Company and sister companies (*i.e.*, joint marketing efforts, trademarks,
4 royalty and license agreements, etc.). Such report is not required of TEP's competitors and
5 places an unnecessary administrative burden on the Company.

6 *Condition No. 28 - Single Investment Limitation* - This condition provides that
7 UniSource (and the sister companies) will not invest an amount greater than \$60 million in
8 any single investment without Commission approval. This condition is inappropriate in a
9 competitive environment given the Commission's mandate to transfer of generation and
10 conduct competitive functions in affiliates. This limitation would not apply to TEP's
11 competitors and would put TEP at a disadvantage. (See also the reasons set forth in
12 Condition No. 19 above.)

13 Other Rules and Orders

14 *General* - The rules and orders set forth below were designed for vertically integrated
15 utilities. The adoption of the Competition Rules and the Company's stranded cost recovery
16 plan as outlined in the Agreement, fundamentally changes the need to impose such
17 requirements on TEP. Additionally, many of these requirements would put administrative
18 burdens on TEP and put the Company at a competitive disadvantage vis-à-vis its competitors
19 who do not have similar requirements.

20 *A.A.C. R14-2-701, et seq. - Integrated Resource Planning Rules* - TEP believes that
21 as these rules apply only to four Affected Utilities which will become UDCs, application of
22 these rules to only these entities is no longer necessary and gives an unfair advantage to
23 competitors who are not subject to the rules. As a UDC, TEP will no longer be in the
24 generation business as the Competition Rules require generation to be transferred to a
25 separate affiliate. Standard offer generation will be required to be procured in the open
26 market. The Competition Rules currently provide for the funding of DSM and other IRP
27 programs through the Systems Benefits Charge and the Competition Rules will establish a
28 Renewable Resource Portfolio Standard. TEP believes that the IRP rules should be
29 suspended and ultimately repealed in favor of the Competition Rules that will apply to all
30 entities equally. Until that happens, TEP requests a waiver of the application of these rules.

1 A.A.C. R14-2-801. et seq. - Affiliate Interest Rules

2 TEP believes that as these rules apply only to the Affected Utilities, application of these rules
3 to only these entities gives an unfair advantage to competitors and are no longer necessary in
4 light of the Code of Conduct. For example, TEP would not be able to use utility funds to
5 invest in affiliates, where ESPs would have no such restrictions. Additionally, there are
6 annual compliance filings for TEP and UniSource contained in these rules that would not
7 apply to competitors. TEP believes that application of these rules with respect to compliance
8 filings and those transactions necessary to comply with the Agreement and the Competition
9 Rules, should be waived for TEP until such time the rules are amended to apply to all entities
10 equally or repealed.

11 *Decision No. 59594 - Mid-Year DSM and Renewables Report* - This requirement was
12 in addition to the IRP Rules. See discussion above regarding A.A.C. R14-2-701, et. seq.

13 *Decision No. 57586 - New Director Affiliate Transaction Report* - This requirement
14 comes from TEP's 1990 rate case following the filing of the bankruptcy petitions against
15 TEP. Under this Decision, the Company is required to file a report detailing transactions and
16 relationships that new TEP Board members had with TEP for a ten-year period. There are
17 several reasons why the Company is requesting a waiver from this requirement. First, it
18 applies only to TEP and does not apply to the Company's competitors. Second, since the
19 Commission entered this Decision, it adopted Affiliated Interest Rules that TEP has operated
20 under and the Company has demonstrated to the Commission through its actions and policies
21 that the need for the filing of this report is no longer necessary. Third, the Commission
22 granted TEP's Holding Company application which contains a condition relating to
23 UniSource Board oversight over affiliate transactions. Fourth, TEP will be entering into a
24 Code of Conduct consistent with the Competition Rules. For these reasons, TEP believes
25 that this requirement should be waived.

26 *Decision No. 58316 - Investment Subsidiary Liquidation Report and Purchase*
27 *Agreement Summary* - This requirement comes from a 1993 decision relating to the
28 liquidation of TEP's investment subsidiaries, TRI and SRI. TEP continues to liquidate such
29 subsidiaries and has been filing reports with the Commission on such activities since 1993.
30 Since that time, TEP has demonstrated that it is complying with the Commission's

1 requirements in liquidating these subsidiaries in a manner that is consistent with the interest
2 of the Company and its customers. Therefore, TEP should be relieved of the obligation to
3 file these reports on a going forward basis as it enters the competitive market. TEP,
4 therefore, requests a waiver from this requirement.

5 *Decision No. 58497 - Avoided Cost Report* - This annual report relates solely to
6 establishing TEP's avoided cost. As avoided cost relates solely to generation, the filing of
7 this report will have no relevance, as TEP will be transferring its generation assets to a
8 subsidiary. TEP, therefore, requests a waiver from this requirement.

9 *Decision No. 57090 - Time of Use Letters* - This semi-annual filing is of the letters the
10 Company sends time-of-use customers relating to the seasonal change in on-peak/off-peak
11 hours. Although TEP will continue to send customers these letters while TEP continues to
12 provide time-of-use rates to customers, it should not have to file such letters with the
13 Commission as generation will be competitive and there is no requirement for other ESPs to
14 file such letters. TEP, therefore, requests a waiver from this requirement.

15 *Decision No. 56659 - Time of Use Report* - This semi-annual filing relates to the
16 Company's time-of-use rates. Although TEP will continue to provide time-of-use rates under
17 its standard offer tariffs, it should not have to file a report with the Commission, as there is
18 no requirement for other ESPs to file such a report. TEP, therefore, requests a waiver from
19 this requirement.

20 *Other Reports or Filings not Necessary Following the Transfer of TEP's Generation*
21 *Assets to an Affiliate* - The following reports all relate to TEP's ownership and operation of
22 generating assets. Once TEP transfers its generating assets to a competitive subsidiary, the
23 requirement of filing the following reports with the Commission should be waived:

- 24 • Decision No. 56526 - Fuel & Performance Filing
- 25 • Decision No. 57924 - Interruptible Report
- 26 • Statistical Data on Generating Units
- 27 • Generating Unit Outage Report

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1 Q. THE AGREEMENT REQUIRES THE COMMISSION TO ISSUE AN APPROVAL
2 ORDER ON OR BEFORE AUGUST 1, 1999 OR THE PARTIES ARE FREE TO
3 WITHDRAW FROM THE AGREEMENT. WHAT IS TEP'S POSITION REGARDING
4 THIS?

5 A. The hearing on the Agreement is not scheduled until August 11, 1999, therefore, the
6 Company recognizes that Commission approval will not be forthcoming by August 1, 1999.
7 However, TEP will continue this process with the understanding that at the conclusion of the
8 hearing, the Commission will conduct an Open Meeting to consider and approve the
9 Agreement. To facilitate this and for the convenience of the Commission, TEP will be filing
10 a Proposed Form of Order. Moreover, as TEP is confident in its Y2K compliance program,
11 the Company now believes that it would be in a position to implement competitive retail
12 access after October 1, 1999 (if necessary), subject to the 60 day implementation window.

13 Q. DO YOU HAVE ANY CONCLUDING REMARKS?

14 A. Yes. For the reasons outlined above, TEP believes that this Agreement is in the public
15 interest and requests that the Commission approve the Agreement in its entirety as soon as
16 possible.

17 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

18 A. Yes.
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TUCSON ELECTRIC POWER COMPANY

Tucson, Arizona

Filed by: Steven J. GlaserTitle: Vice President, Rates & Regulatory SupportDistrict: Entire Electric Service AreaTariff No. RIDER NO. 1Sheet No. 1 of 1

Revision No. _____

Effective: _____

ADDER ASSOCIATED WITH MGC – RIDER NO. 1

(all prices in mills per kWh)

Residential & General Service (to 200 kW); (Rates 1 & 10)

Summer kWh up to 115% of winter kWh	3.2
Summer kWh greater than 115% but less than or equal to 145% of winter kWh	3.7
Summer kWh greater than 145% but less than or equal to 175% of winter kWh	4.2
Summer kWh greater than 175% but less than or equal to 205% of winter kWh	4.7
Summer kWh greater than 205% of winter kWh	5.2

Large General Service (over 200 kW); (Rate 13)

Summer kWh up to 106% of winter kWh	2.5
Summer kWh greater than 106% but less than or equal to 136% of winter kWh	2.9
Summer kWh greater than 136%	3.3

Large Light & Power Rate 14 and Contract Customers

Liquid Air	2.5
Fort Huachuca	2.5
Arizona Portland Cement	2.5
IBM	2.5
Asarco Mission 1	2.5
Asarco Mission 2	2.5
Asarco Silverbell	2.5
Cyprus	2.5
University of AZ (Main)	2.5
University of AZ (Medical)	2.5
University of AZ (Heating & Refrig.)	2.5
Burr Brown	2.5
DM AFB	2.5
Raytheon	2.5

TUCSON ELECTRIC POWER COMPANY

Tucson, Arizona

Filed by: Steven J. Glaser

Title: Vice President, Rates & Regulatory Support

District: Entire Electric Service Area

Tariff No. RIDER NO. 2

Sheet No. 1 of 1

Revision No.

Effective:

MUST-RUN GENERATION – RIDER NO. 2

Must-Run Generation - Rider No.2

Variable Component	\$ 0.00162 per kWh
Fixed Component	
Residential Service	\$ 0.00432 per kWh
General Service - Rate No. 10	0.00514 per kWh
Large General Service - Rate No. 13	0.00360 per kWh
Large Light & Power - Rate No 14	0.00288 per kWh
Lighting	0.00432 per kWh
Public Authority	0.00432 per kWh
(Average Fixed Component)	\$ 0.00432 per kWh

Variable component is billed to scheduling coordinator.

Fixed component is billed directly to end-use customer.

During a month in which must-run generation is provided to meet retail load, the Market Price component used in calculating the on-peak MGC shall be a weighted average of the Palo Verde NYMEX futures price and the must-run variable cost charges that are levied on scheduling coordinators serving retail customers in the TEP load zone during that month, consistent with AISA protocols.

TUCSON ELECTRIC POWER COMPANY

Tucson, Arizona

Filed by: Steven J. GlaserTitle: Vice President, Rates & Regulatory SupportDistrict: Entire Electric Service AreaTariff No. RIDER 3Sheet No. 1 of 2

Revision No. _____

Effective: _____

TRANSMISSION AND ANCILLARY SERVICES – RIDER NO. 3**Transmission**

Group "A" : For customers under 20 kW and not demand metered.

Applicability: Required for Direct Access Service, but not purchased directly by the customer. Sold to scheduling coordinator pursuant to the OATT. The rates in Transmission Credit – Rider No. 5 will be used for the Transmission Credit in the calculation of the floating CTC. These rates are based on the Company's OATT, but are converted to a kWh-basis for specific load-profiled customer groups. For illustrative purposes, estimated rates are shown in selected Direct Access tariffs.

Note: A loss factor adjustment shall be made for transmission and ancillary services.

Group "B" : For customers not in Group A.

Applicability: Required for Direct Access Service, but not purchased directly by the customer. Sold to scheduling coordinator pursuant to the Company's FERC OATT. The following OATT rate is shown below for information and for calculation of the floating CTC (See Transmission Rider No. 3).

As of June 7, 1999, the transmission charges are as follows:

EHV	Non-EHV	
2.259	\$0.757000	per kW / Month

Note: A loss factor adjustment shall be made for transmission and ancillary services.

Ancillary Services

Group "A" : For customers under 20 kW and not demand metered.

Applicability: Required for Direct Access Service, but not purchased directly by the customer. Sold to scheduling coordinator pursuant to the OATT. The rates in Transmission Credit – Rider No. 5 will be used for the Transmission Credit in the calculation of the floating CTC. These rates are based on the Company's OATT, but are converted to a kWh-basis for specific load-profiled customer groups. For illustrative purposes, estimated rates are shown in selected Direct Access tariffs.

Services covered:

1. System Control & Dispatch
2. Reactive Supply and Voltage Control
3. Regulation and Frequency Response
4. Energy Imbalance Service
5. Spinning Reserve Service
6. Supplemental Reserve Service

Notes:

- A loss factor adjustment shall be made for transmission and ancillary services.
- Energy Imbalance Service currently charged pursuant to the Company's OATT, which is subject to change pursuant to AISA protocols.

TUCSON ELECTRIC POWER COMPANY

Tucson, Arizona

Filed by: Steven J. GlaserTitle: Vice President, Rates & Regulatory SupportDistrict: Entire Electric Service AreaTariff No. RIDER 3Sheet No. 2 of 2

Revision No. _____

Effective: _____

TRANSMISSION AND ANCILLARY SERVICES – RIDER NO. 3

Group "B" : For customers not in Group A.

Applicability: Required for Direct Access Service, but not purchased directly by the customer. Sold to scheduling coordinator pursuant to the Company's FERC OATT. The following OATT rates are shown below for information and for calculation of the floating CTC (See Transmission Rider No. 3).

As of June 7, 1999, the charges are as follows:

Service		
System Control & Dispatch	\$0.041000	per kW / Month
Reactive Supply and Voltage Control	\$0.161000	per kW / Month
Regulation and Frequency Response	\$0.156000	per kW / Month
Energy Imbalance Service	(see note)	
Spinning Reserve Service	\$0.423000	per kW / Month
Supplemental Reserve Service	\$0.069000	per kW / Month

Notes:

- A loss factor adjustment shall be made for transmission and ancillary services.
- Energy Imbalance Service currently charged pursuant to the Company's OATT, which is subject to change pursuant to AISA protocols.

TUCSON ELECTRIC POWER COMPANY

Tucson, Arizona

Filed by: Steven J. Glaser

Title: Vice President, Rates & Regulatory Support

District: Entire Electric Service Area

Tariff No. RIDER NO. 4

Sheet No. 1 of 1

Revision No.

Effective:

FIXED CTC BY CLASS - RIDER NO. 4

Fixed CTC by Class - Rider No. 4

The average of Fixed CTC by class is \$0.0093 per kWh

By class, the fixed CTC is:

Residential	0.0093 per kWh
General Service (Rate No. 10):	0.0111 per kWh
Large General Service (Rate No. 13):	0.0078 per kWh
Large Light and Power (Rate 14):	0.0062 per kWh
note: this is an average charge based on a 75% load factor.	
Rate No. 14 and Special Contract charges shall be adjusted such that	
a 60% load factor customer is charged:	0.0078 per kWh
and a 90% factor customer is charged:	0.0046 per kWh
Lighting:	0.0093 per kWh
Public Authority:	0.0093 per kWh